

No. 16348
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

IRVING I. BASS, Trustee in Bankruptcy of the Estate of
LELAND CAMERON, Bankrupt,

Appellee.

On Appeal From the Order of the United States District
Court for the Southern District of California.

BRIEF OF APPELLEE.

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TOPICAL INDEX

	PAGE
Statement	1
Question presented	1
Argument.....	2
Post-bankruptcy interest is not allowable on statutory lien claims, including tax lien claims.....	2
Conclusion	25

TABLE OF AUTHORITIES CITED

CASES	PAGE
Cameron, In re, 166 Fed. Supp. 400.....	16
Childress, G. N., Matter of (M. D., N. C., 1958).....	16
C. J. Dick Towing Company, In re, 161 Fed. Supp. 751.....	18
Goggin v. California Labor Division, 336 U. S. 118.....	22
Industrial Machine & Supply Co., In re, 112 Fed. Supp. 261.....	13
Jefferson Standard Life Ins. Co. v. United States, 247 F. 2d 777	7
Lykens Hosiery Mills, In re, 141 Fed. Supp. 95.....	11
Macomb Trailer Coach, In re, 200 F. 2d 611.....	6
Marcalus Manufacturing Co. v. United States, 169 Fed. Supp. 821	16
Mighell, In re, 168 Fed. Supp. 811.....	16
New York v. Saper, 336 U. S. 328.....	2, 3, 5, 6, 21, 22, 23
Palo Alto Mutual Savings and Loan Ass'n v. Williams, 245 F. 2d 77	7, 8
Parchem, In re, 166 Fed. Supp. 724.....	19, 20, 21
Rochelle v. City of Dallas, 264 F. 2d 166.....	23
Sword Line v. Industrial Commissioner of State of New York, 212 F. 2d 865.....	20
United States v. Edens, 189 F. 2d 876, aff'd 342 U. S. 912...	2, 3, 5, 9
United States v. England, 226 F. 2d 205.....	3
United States v. Harrington, No. 7812 (4th Cir.).....	16
Vanston Committee v. Green, 329 U. S. 156.....	24
Young, In re, 171 Fed. Supp. 317.....	14

STATUTES

Bankruptcy Act, Sec. 57n.....	9
Bankruptcy Act, Sec. 64a	4
Bankruptcy Act, Sec. 67b.....	3

	PAGE
Bankruptcy Act, Sec. 67c(1)	3, 8, 9, 20, 23
Bankruptcy Act, Sec. 67c(2)	9, 22, 23
Internal Revenue Code, Sec. 6321.....	3, 4, 7
Internal Revenue Code, Sec. 6322	3, 4
Internal Revenue Code, Sec. 6323.....	3
Internal Revenue Code, Sec. 6601.....	4
United States Code, Title 11, Sec. 93n.....	9
United States Code, Title 11, Sec. 104a.....	4
United States Code, Title 11, Sec. 107b.....	3
United States Code, Title 11, Sec. 107(c) (1).....	3, 8, 9, 10, 20
United States Code, Title 11, Sec. 107c(2)	9, 23

MISCELLANEOUS

Commerce Clearing House Bankruptcy Law Reports, No. 103, June 4, 1959, par. 59,490.....	18
33 Journal of National Association Ref. in Bankr. (Jan., 1959), pp. 12, 15.....	17
2 Remington on Bankruptcy, pp. 224-225.....	10

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BRIEF OF APPELLEE.

Statement.

The facts are correctly set forth in Appellant's "Statement." (Op. Br. pp. 2-5.)

Question Presented.

Does interest cease to accrue upon statutory lien claims as of the date of bankruptcy, or are such claims entitled to post-bankruptcy interest to the date they are actually paid by the Trustee?

ARGUMENT.

Post-Bankruptcy Interest Is Not Allowable on Statutory Lien Claims, Including Tax Lien Claims.

As conceded by Appellant (hereinafter sometimes referred to as the "Government"), it has long been the general rule that claims in bankruptcy cease to accrue interest after the filing of the petition.¹ Prior to 1949, an exception to this general principle was usually made in the case of debts owing to taxing agencies. In that year, however, *New York v. Saper*, 336 U. S. 328 (1949), a decision involving both New York and federal taxes, eliminated the exception.

The justification for denying post-bankruptcy interest on tax claims was subsequently well stated by the Fourth Circuit in an opinion which the Supreme Court affirmed:

"The real reason . . . is that the delay resulting from the institution of the proceeding should not be permitted to benefit one class of creditors at the expense of another, but that the rights of all should be determined as of the commencement of the proceeding. It is easy to see that post bankruptcy interest on tax claims in ordinary bankruptcy comes out of assets to which other creditors would be entitled . . . [N]o class of creditors should be allowed to profit at the expense of another because of a delay for which the law is responsible."

United States v. Edens, 189 F. 2d 876, 877-878 (C. A. 4, 1951), *aff'd* 342 U. S. 912.

¹"More than forty years ago Mr. Justice Holmes wrote for this Court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle of the English bankruptcy system which we copied." *New York v. Saper*, 336 U. S. 328, 330 (1949).

Concededly, the *Saper* and *Edens* decisions dealt with ordinary or non-lien taxes, whereas in the present case the Appellant's claim is supported by a statutory lien which arose before bankruptcy under the provisions of Sections 6321 and 6322 of the Internal Revenue Code.² But the existence of a statutory lien, while significant in bankruptcy for some purposes,³ does not alter the situ-

²Throughout the Government's brief, it is frequently asserted with considerable emphasis that the tax lien in question became "perfected" prior to bankruptcy. Actually, "perfection" is a concept having no materiality in the present case. It was stipulated that the assessment was made before bankruptcy [Tr. R. pp. 9-10]; and by statute, the tax lien arose at the time of assessment. I. R. C., Section 6322. Under Section 67b of the Bankruptcy Act, 11 U. S. C., Section 107b, a statutory lien *arising* prior to bankruptcy may be "perfected" thereafter; the date of "perfection" accordingly is not crucial under this section.

Section 67c(1) of the Act, 11 U. S. C., Section 107(c)(1), provides in effect for subordination of the federal tax lien on personality to administration expenses and priority wage claims unless the Government takes possession of the liened property prior to bankruptcy. The Appellant does not contend that its lien was "perfected" in the sense of a taking of possession, for this never occurred; there is no dispute but that the postponement provisions of Section 67c do apply in the present case.

The only other meaning which "perfection" could have here relates to I. R. C., Section 6323, which makes the tax lien invalid as against a mortgagee, pledgee, purchaser or judgment creditor until the prescribed notice is recorded. There is nothing in the present record to indicate whether the notice was filed before or after bankruptcy, if indeed it has ever been filed. Moreover, even this is unimportant since a trustee in bankruptcy has been held to be unprotected by I. R. C., Section 6323, regardless of the notice filing. *United States v. England*, 226 F. 2d 205 (C. A. 9, 1955). (See Op. Br. p. 19, n. 6.)

In short, the "perfection" concept neither adds to nor detracts from the Government's position, and the repeated use of the word in this case can serve no purpose other than possibly to cloud the real issue.

³A tax claim supported by a statutory lien ranks higher in bankruptcy than non-lien taxes, even in cases such as the present one where the lien is postponed by Section 67c(1) of the Bankruptcy Act, 11 U. S. C., Section 107c(1). Thus, the Government's lien

ation insofar as the Government's right to post-bankruptcy interest is concerned. Appellant, of course, strongly relies on the fact that I. R. C., Section 6321 creates a lien which, as a general proposition, supports both the principal of the tax and the interest accrued thereon. Appellee has no quarrel with the Government's analysis of the nature of its lien. (Op. Br. pp. 13-19.) If bankruptcy had not occurred, he would agree with Appellant that the lien could not be discharged from the taxpayer's property unless all interest as well as the tax were paid. (See I. R. C., Sec. 6322.)

What the Government overlooks, however, is the fact that a statutory lien does not by itself create an independent liability; rather, it only acts as security for a debt otherwise owing, and cannot secure more than the amount validly due. Section 6321 of the Internal Revenue Code, which provides for the tax lien, does not impose any liability upon the taxpayer to pay interest, or even to pay the tax. It merely grants the Director a means of securing collection of moneys due him under other sections of the Code. The provision creating the duty to pay interest on delinquent taxes—whether or not the lien ever arises—is I. R. C., Sec. 6601. This section (or, more accurately, its counterpart under the former Internal Revenue Code)

claim is paid its full amount, exclusive of disallowed interest, immediately following payment of administration expenses and priority wages, and ahead of general taxes in the fourth priority class created by Section 64a of the Act, 11 U. S. C., Section 104a. If there were no lien, Appellant would have to share pro rata with other tax claimants. For this reason, it is misleading for the Government to suggest that disallowance of post-bankruptcy interest is tantamount to relegating its statutory lien claim to the status of a mere fourth priority. (See, *e.g.*, Op. Br. pp. 28, 31-32.)

is exactly the one involved in *New York v. Saper, supra*, and cases such as *United States v. Edens, supra*, which followed. The Government argued in *Saper* that the Code made the interest a part of the tax, and that nothing in the Bankruptcy Act called for a disallowance of a portion of the tax claim. As noted above, the Supreme Court rejected this contention and held that despite the revenue statute, the historic rule cutting off post-petition interest governed the amount for which tax claims are allowable in bankruptcy:

“Moreover, there is no interest except that which accrues according to law—it is exactly such interest that the ‘fundamental principle’ cuts off as of bankruptcy.” (*New York v. Saper*, 336 U. S. at 331-332.)

. . .

“It has been held that federal taxes ordinarily bear interest even in the absence of statute. . . . But we do not think either such a rule or statutory provision could be permitted to negative the Bankruptcy Act’s requirement in that respect if the latter be to the contrary, as we think it is.” (*Id.* at 340-341, n. 18.)

In view of the foregoing, it is fallacious for the Government to urge that disallowance of post-bankruptcy interest constitutes a partial invalidation of the tax lien which is not authorized by the Bankruptcy Act. (*E.g.*, Op. Br. pp. 37-38, 51.) The real issue concerns the amount validly allowable in bankruptcy on the claim for which the lien is security. Whatever this sum may be,

the statutory lien will be fully recognized.⁴ It is Appellee's position that *Saper* furnishes the answer to this crucial question.

The Government, however, attempts to bring itself within certain exceptions to the general rule against post-bankruptcy interest which have been applied in some decisions involving contractually secured claims. The extent of these exceptions, even in cases of a consensual security, is far from clear and has never been decided by the Supreme Court.⁵ In the *Saper* case, the Court noted in passing only two situations where the general rule did not apply:

"if the alleged 'bankrupt' proved solvent, creditors received post-bankruptcy interest before any surplus reverted to the debtor . . . ; and if securities held by a creditor as collateral produced interest or dividends during bankruptcy such amounts were applied to post-bankruptcy interest. . . ." (336 U. S. at 330, n. 7.)

Neither of these exceptions, of course, helps the Appellant in the present case. Nevertheless, it must be admitted that a third type of exception has been announced by certain Courts of Appeal, notably by the Sixth Circuit in *In re Macomb Trailer Coach*, 200 F. 2d 611 (1953), and by this Court in *Palo Alto Mutual Savings and Loan*

⁴When the problem is correctly analyzed, there is obviously no merit to the Government's argument that an affirmance of the order below would make the right to post-bankruptcy interest turn on the results of the lienor's race to take possession of the lienor's assets before bankruptcy. (Op. Br. p. 26.) If, as Appellee submits, there is a general rule which cuts off post-petition interest, even a lienor in possession could not realize upon the security for more than the total amount owed him under the law—and this amount would not include the disallowable interest factor.

⁵One of the excepted categories concerns the case of the solvent debtor. Since the cutting off of post-petition interest is a rule of *insolvency* practice, it probably would be more technically accurate to term the situation of the solvent debtor one where the general rule did not apply, rather than considering it an exception to the rule.

Ass'n v. Williams, 245 F. 2d 77 (1957), and *Jefferson Standard Life Ins. Co. v. United States*, 247 F. 2d 777 (1957), namely:

“where . . . the proceeds of the sale of the mortgaged properties are sufficient to pay post-bankruptcy interest to the secured creditor.” (245 F. 2d at 79.)

To allow post-petition interest on a statutory lien on the theory that it fits within this third exception would run counter to the weight of present authority, as will be seen below. Moreover, such a step is not required by the logic of the Bankruptcy Act, nor, when the full implications are considered, is it supported by the so-called policy considerations urged by the Government.

The third exception, at least as it was stated by this Court in the *Palo Alto* opinion quoted above, seems to apply to “mortgages” or trust deeds, and no doubt to other types of bargained for security, but is not phrased in terms readily applicable to statutory liens. No decision of a Court of Appeals has as yet so applied it.

This third exception, furthermore, becomes awkward in form when it is extended to the federal tax lien. That is to say, the Government’s statutory lien is a floating, general charge on all the taxpayer’s property and rights to property. (I. R. C., Sec. 6321.⁶) Unlike the cases in-

⁶The Government’s opening brief discusses at several points the question of whether the federal lien is “general” or “specific” or both, a matter which Appellee deems to be of no importance. Whether a lien is general or specific, choate or inchoate, perfected or unperfected, involves concepts that are relevant in cases of competition for priority between the federal lien and other security devices; they have little or no bearing, however, on the rights of the tax lien *vis-a-vis* a trustee in bankruptcy. See note 2, *supra*. When Appellee designates the tax lien as “general” in this brief, all that is meant is that the lien reaches every interest or right owned by the taxpayer-bankrupt, and thus everything which might become a part of the bankrupt estate.

volving the usual contractual security, the property subject to the tax lien, being the entire bankrupt estate, must always be sufficient to pay the interest in full, or else other creditors could not possibly receive any dividend. In effect, the third exception as applied under the Government's contention in this case would read: "Post-bankruptcy interest is payable on the federal tax lien whenever the total assets of the estate are sufficient to pay it."⁷ The language used in *Palo Alto* to define the third type of exception there involved is hardly well suited to a description of the result urged by the Government here.

Nevertheless, Appellant maintains in effect that the third exception refers to secured claims, that a statutory lien is a type of secured claim, and that the Bankruptcy Act does not distinguish in any material respect between kinds of secured indebtednesses. To be sure, for some purposes a statutory lien is a secured debt in bankruptcy and receives a treatment different from that accorded unsecured claims. But the District Judge in his opinion below pointed out several significant factual differences between consensual and statutory liens. The Bankruptcy Act, moreover, itself makes certain distinctions between statutory liens, on the one hand, and claims involving contractual security, on the other, treating the former less favorably. These distinctions, Appellee submits, are important in the resolution of the present issue concerning post-bankruptcy interest.

It is fundamental that contracted for liens and encumbrances—*e.g.*, trust deeds, mortgages, conditional sales

⁷Subject, of course, to prior payment of administration expenses and priority wages in cases affected by Section 67c(1) of the Act, 11 U. S. C., Sec. 107c(1).

agreements and the like—which are valid under applicable state law are unaffected by bankruptcy. Statutory liens, however, usually feel the impact of the filing of the petition. Thus, Section 67c(2) of the Bankruptcy Act, 11 U. S. C., Sec. 107c(2), renders void as against the trustee most state-created statutory liens on personal property unless the lienor has seized or levied upon the assets prior to bankruptcy. More in point here, under Section 67c(1), 11 U. S. C., Sec. 107c(1), federal and state statutory tax liens on personalty, while not invalidated, are subordinated to the payment of expenses of administration and priority wage claims, unless the tax collector has taken possession of the property before bankruptcy.

The foregoing provisions of the Act are obviously relevant to the present problem. One main reason for the general rule denying post-petition interest is that “no class of creditors should be allowed to profit at the expense of another because of a delay for which the law is responsible.” (*United States v. Edens*, 189 F. 2d 876, 878 (C. A. 4, 1951), *aff'd* 342 U. S. 912.) In situations involving contracted for security, the trustee can avoid the accrual of interest by promptly paying the secured debt which is unaffected by bankruptcy. Accordingly, little or no delay is compelled by law. Usually, however, he cannot act with similar dispatch in the case of a tax or other statutory lien, where, as here, the postponement provisions of Section 67c(1) apply. Until the amount of the priority wages are determined, a matter generally entailing at least the expiration of the six months claim period under Section 57n, 11 U. S. C., Sec. 93n, and until allowances are made by the court for expenses of administration, an event which of necessity must occur

at the closing of the estate, the Act itself prevents the trustee from paying statutory lien claims, since they are junior in priority to the two described classes.⁸ A holding that other creditors must suffer by the allowance of interest to the tax collector during the compulsory waiting period would not seem justified in view of the reason for the rule denying post-bankruptcy interest.

The weight of the present authorities is in accord with Appellee's position. A leading treatise, 2 Remington on Bankruptcy, pp. 224-225, states the law as follows:

"A governmental or public claim can include interest in like manner and to the same extent as any other claim, but to no greater extent. It cannot include interest accruing after the filing of the bankruptcy or reorganization petition, even though it has been reduced to lien form."

While no Court of Appeals has as yet decided the matter, with only one exception all the reported decisions of the District Courts and the referees in bankruptcy have denied post-bankruptcy interest on statutory lien claims, even in jurisdictions observing the third exception which permits such interest on contractually secured

⁸For these reasons, it is simply incorrect for the Government to assert that "No delay until final distribution is requisite in the case of a secured claim" (Op. Br. p. 50), if, as the context implies, the statutory tax lien is included within the term "secured claim."

In the unusual case where the Government has actually seized the lien property before bankruptcy, Appellee's argument based on Section 67c(1) admittedly loses force (although the other reasons set forth for denying post-bankruptcy interest do not depend on the fact of possession). The right to post-bankruptcy interest, however, should not turn on the physical location of the assets. See note 4, *supra*. Appellee's point is that Section 67c(1) must be given great weight in determining a general rule concerning interest on statutory liens, because its postponement provisions do apply in the vast majority of cases, including the present one.

debts. Directly in point is *In re Lykens Hosiery Mills*, 141 Fed. Supp. 895, 897-898 (S. D. N. Y., 1956), where the Court held:

“With respect to the question of post-petition interest, the general rule is well settled that interest ceases to run on secured and unsecured claims as of the date of the filing of the petition under the Bankruptcy Act. *City of New York v. Saper*, 336 U. S. 328, 69 S. Ct. 554, 93 L. Ed. 710; *Vanston Bondholders Protective Committee v. Green*, 329 U. S. 156, 67 S. Ct. 237, 91 L. Ed. 162; *Sexton v. Dreyfus*, 219 U. S. 339, 31 S. Ct. 256, 55 L. Ed. 244. This proposition is also applicable to tax claims which have been reduced to liens. *In re Industrial Machine & Supply Co.*, D.C.W.D. Pa. 1953, 112 F. Supp. 261. However, the government does not predicate its claim for post-petition interest upon the ground that it possesses a validly perfected tax lien. The government contends that it is a secured creditor holding security which is more than sufficient in value to pay both principal and interest on its claim, and that, therefore, its claim for post-petition interest should be allowed under Section 63, subdivision a(1) of the Bankruptcy Act as an exception to the general rule.

“It is well settled that there are certain exceptions to the general rule with respect to the payment of interest on secured claims. Under the first exception, post-petition interest is allowed where the security held produces income during the administration of the bankrupt’s estate. *Vanston Bondholders Protective Committee v. Green*, 329 U. S. 156, 67 S. Ct. 237, 91 L. Ed. 162; *Sexton v. Dreyfus*, 219 U. S.

339, 31 S. Ct. 256, 55 L. Ed. 244. The second exception arises if in the administration of the bankrupt estate it develops that the estate is solvent. In such case interest is allowed on secured claims up to the date of payment of said claims. *Brown v. Leo*, 2 Cir., 1929, 34 F. 2d 127. A third exception has been recognized by the courts, and it is this exception upon which the government relies in this proceeding. Where the value of the security is more than sufficient to pay both principal and interest thereon to the date of payment of the claim secured thereby, it has been held in *Weeks v. McInnis*, 6 Cir., 1952, 200 F. 2d 611, certiorari denied 345 U. S. 958, 73 S. Ct. 940, 97 L. Ed. 1378, that interest on said claim should be allowed to the date of payment.

“In the *Weeks* case, *supra*, post-petition interest was allowed on a vendor's lien on certain real estate for the balance of the purchase price which the debtor had contracted to pay. However, the security which the government possesses in this proceeding is in the form of a *general* lien perfected pursuant to the provisions of Section 3670 of the Internal Revenue Code of 1939, 26 U. S. C. A., ‘upon all property and rights to property, whether real or personal’. A general lien of this type is distinguishable from the specific security involved in those cases where the courts have seen fit to recognize the existence of an exception to the general rule that interest ceases to run on secured and unsecured claims as of the date of the filing of the petition in bankruptcy. The distinction lies in the fact that the specific security involved in the cases where an exception was found was usually the result of a voluntary transaction be-

tween the debtor and the creditor and the payment of interest was contemplated by the parties. This Court, therefore, is reluctant to extend the application of the third exception to allow interest on a tax lien to the date of payment where the security consists of a general lien 'upon all property and rights to property, whether real or personal' belonging to the bankrupt.

"Accordingly, I conclude that the Referee was correct in disallowing the government's claim for post-petition interest."

A similar holding was made in *In re Industrial Machine & Supply Co.*, 112 Fed. Supp. 261, 263 (W.D. Pa., 1953):

"The law appears clear and unequivocal that tax claims in bankruptcy, in an arrangement proceeding, or in a reorganization proceeding bear interest only to the date of bankruptcy or to the date of the filing of the arrangement or reorganization proceeding. *City of New York v. Saper*, Trustee in Bankruptcy, 336 U. S. 328, 69 S. Ct. 554, 93 L. Ed. 710 (Bankruptcy); *United States v. Edens*, 4 Cir., 189 F. 2d 876; Chapter X, 11 U. S. C. A. § 501 et seq. (Reorganization); *United States v. General Engineering & Manufacturing Co.*, 8 Cir., 188 F. 2d 80, 81; Chapter XI, 11 U. S. C. A. § 701 et seq. (Arrangement).

"As a matter of public policy the courts have recognized that as a general rule, after property of an insolvent passes into the hands of a receiver, interest is not allowed against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate. *Thomas v. Western Car Co.*, 149 U. S. 95, 13 S. Ct. 824,

37 L. Ed. 663; Vanston Bondholders Protective Committee v. Green, 329 U. S. 156, 67 S. Ct. 237, 91 L. Ed. 162.

“The government has concurred in the view that tax claims against a bankrupt bear interest only until the date of bankruptcy, but seeks to distinguish between those tax claims reduced to liens and tax claims not reduced to liens, advancing the argument that the general rule of interest herein enunciated has application only to tax claims not reduced to liens.

“I find no basis in law or policy for this arbitrary distinction. A meticulous examination of the authorities reveals no such tortured classification.”

In re Young, 171 Fed. Supp. 317 (W. D. Wis., 1959), affirming the referee in bankruptcy and adopting his opinion, reached the same conclusion:

“This decisive Saper case was decided in 1949, almost 10 years ago. It transmitted to the Congress notice that if the termination date for interest on United States or other tax claims was to be other than the date of filing of the petition in bankruptcy, *it is or was the function of Congress, and not of the Courts, to make the change. It is significant, really significant, that the Congress, despite such notice, has remained entirely silent in the premises over this entire period.* And the Court adjudged, also, that a statutory provision for post-bankruptcy interest on tax claims must be more than a mere vague provision by the Congress.” (171 Fed. Supp. at 321.)

...

“However, the United States earnestly contends that the tax lien statute, above mentioned, and the perfection of its tax lien, give it the status of a secured creditor, and the privilege of post-bankruptcy interest.” (171 Fed. Supp. at 321.)

. . .

“... the only provision with respect to interest in that [tax lien] statute is that the lien is on all property for the amount of the tax ‘including any interest’. This can mean only interest according to law, that is, to the date of filing the petition in bankruptcy.” (171 Fed. Supp. at 322.)

. . .

“It is important to note in the doctrine declared by the Court in the Saper case, *supra*, that much of the quote has to do with *secured claims*. For instance, a judgment properly docketed and processed places the judgment creditor in a secured status, in other words, renders him a secured creditor; *and the Bankruptcy Act, Sec. 63, sub. a (1), expressly denies such a secured creditor post-bankruptcy interest.*” (171 Fed. Supp. at 323.)

. . .

“Lastly, it is important to note, that when Congress enacted the tax lien statute, and this was subsequent to the decision in the Saper case, Congress did not see fit to include an express provision for post-bankruptcy interest on tax claims liened thereunder.” (171 Fed. Supp. at 323.)

. . .

“The Referee is convinced that the statutory tax lien provisions are designed to aid in the collection of taxes, and that a perfected tax lien gives the tax-

ing unit no more rights or privileges than is accorded judgment creditors by Sec. 63, sub. a(1) and (5) of the Bankruptcy Act, and this conclusion seems inevitable especially in view of the failure of Congress to repudiate this 'general principle' of and 'implicit' in our system of bankruptcy to the effect that interest terminates at the time of bankruptcy." (171 Fed. Supp. at 324-325.)

Other reported District Court decisions disallowing post-petition interest to the Government's statutory lien claim are *In re Mighell*, 168 Fed. Supp. 811 (D. Kan., 1958), and the decision of Judge Yankwich in the case here under appeal, *In re Cameron* 166 Fed. Supp. 400 (S. D. Cal., 1958).⁹

United States v. Harrington, currently pending as No. 7812 in the Fourth Circuit according to the Government's brief (Op. Br. p. 34), involves an appeal from the order of District Judge Hayes in *Matter of G. N. Childress*, affirming the decision of Referee in Bankruptcy Reynolds (M. D. N. C., 1958). The Referee's opinion is reported

⁹*Marcalus Manufacturing Co. v. United States*, 169 Fed. Supp. 821 (Ct. Cls., 1959), cited in the Government's brief (Op. Br. p. 34, n. 9) seems to lend some support to Appellee's position here. Although the opinion does not clearly state that a lien was involved, it does set forth that the tax assessment was made before the reorganization proceeding was filed, with the necessary result that a lien must have arisen prior to the petition. Post-petition interest was allowed in *Marcalus* for the sole reason that the debtor's estate was solvent. At least for the purpose of statutory lien claims, the Court recognized only two exceptions to the general rule prohibiting post-bankruptcy interest, namely, the solvency situation and the case where the security itself produced income during bankruptcy. It was not intimated in any way that the Government might be entitled to interest on its tax lien because of the so-called third exception upon which Appellant must depend in the present case.

in 33 J. Nat'l Ass'n Ref. in Bankr. 12, 15 (Jan. 1959), in part as follows:

“What is said above would seem to be dispositive of the question here, since post-bankruptcy interest cut off under the Act can hardly be invigorated by the existence of a tax lien. However, the government contends that the *Saper decision* may be disregarded and that such decisions as *In re Industrial Machine & Supply Co.*, 112 F. Supp., 261 (D. C. Pa. 1953) and *In re Lykens Hosiery Mills*, 141 F. Supp., 895, *supra*, holding that liened tax claims are ordinarily no different than unliened tax claims, are not here applicable. The ground advanced is that in this instance the bankrupt estate is adequate to pay interest on the tax lien claims, and that by reason thereof the present claims come within an exception to the general post-petition interest rule recognized in *Weeks v. McGinnis*, 200 F. (2d) 611 (6 Cir., 1952). *certiorari denied* 345, U. S. 958, 97 L. ed. 1378, 73 S. Ct. 940.”

. . . .

“The suggested analogy breaks down rapidly, since the liens for taxes as against personalty are postponable to the extent specified in Section 67(c) of the Act. (Being subordinated to cost of administration and wage claims). Moreover, a general lien of this type is distinguishable in its fundamental nature from the specific security involved in the *Weeks* case, and in other cases where post-bankruptcy interest has been allowed on private liens, *cf. Brown v. Leo*, 34 F. (2d) 127 (2 Cir., 1929); *Sexton v. Dreyfus*, 219 U. S. 339, 55 L. ed. 244, 31 S. Ct. 256. Unlike liens based upon a voluntary contract

entered into between individual parties, the tax liens here do not arise out of any transaction contributing a prior economic benefit to the bankrupt. Where the transaction is in the ordinary course of business, the lienholder extends something of value to his debtor and thus indirectly to others dealing with the debtor. Considerations of fair play thus impel the allowance to the lienholder, as against unsecured lesser creditors, of whatever he had the foresight to secure to the extent that his security will permit, including interest until payment. A taxing agency, however, has made no investment in the estate of the debtor, and when it seeks to recover interest it seeks to earn a return without having extended any economic benefit or taken any economic risk. Therefore, while it is appropriate that general creditors should yield to secured creditors who have bargained for security itself sufficient to provide for the payment of interest, no similar appropriateness appears in forcing them to yield to a tax lien. This is the holding of the District Judge in *In re Lykens Hosiery Mills*, *supra*, and I agree with his reluctance to extend the exception of the *Weeks* case this far."

Other holdings by the referees in bankruptcy, although rarely appearing in official reports, seem to be in line with the foregoing precedents. For example, the report of the District Court's opinion in *In re C. J. Dick Towing Company*, 161 Fed. Supp. 751 (S. D. Tex., 1958) ¹⁰ sets forth that the referee disallowed post-petition interest on the federal tax lien, a point on which the Government did not there seek a review.

¹⁰Affirmed by the Fifth Circuit on May 13, 1959, C. C. H. Bankruptcy Law Reports, No. 103, June 4, 1959, par. 59,490.

The only case which supports Appellant's position is Judge Nordbye's opinion in *In re Parchem*, 166 Fed. Supp. 724 (D. Minn., 1958). *Parchem* has been criticized, however, in a note in the Journal of the National Association of Referees in Bankruptcy, a criticism which Appellee submits is sound:

"The *Lykens* case, *supra*, denied the government's claim as a tax lien is general and non-consensual, as distinguished from the more usual secured creditor who is allowed interest to the date of payment, if the estate's equity in the mortgaged property is large enough to pay it. The present case felt that this was not a valid distinction and refused to follow it. Three recent Supreme Court cases were cited, all of which hold that a Federal lien has an equal status with a specific lien, *United States v. City of New York*, 347 U. S. 81 (1953); *United States v. R. F. Ball Construction Co., Inc.*, 355 U. S. 587 (1958); *United States v. White Bear Brewing Company*, 352 U. S. 1010 (1955). None of these cases, however, were concerned with bankruptcy, or the question here involved, but dealt instead with various priority of lien questions.

"In *City of New York v. Saper*, 336 U. S. 328 (1948), the Supreme Court resolved a conflict between the Circuit Courts of Appeals by holding the post-bankruptcy interest should not be allowed on a tax claim. The present case does not mention the *Saper* case, perhaps concluding it does not apply where there is a perfected tax lien. Instead, this court looks only to the usual wording of the exception involved to the no post-bankruptcy interest rule, and decides that a tax lien fits within the literal meaning. In so doing, however, the court cuts a

major inroad into the *Saper* doctrine by allowing interest to the date of payment in the bulk of bankruptcy cases. No doubt this case will be relied upon by the Commissioner of Internal Revenue in many other jurisdictions. Taxes are given a favored treatment at present under the Bankruptcy Act, however, interest is not a tax. In addition to full satisfaction of its tax lien, the government would receive interest past the date of bankruptcy. The funds used to pay that interest will in most cases come from the pockets of the unsecured creditors. It would seem that the policy prohibiting tax penalties would apply as well to post-bankruptcy tax interest.” (33 J. Nat’l Ass’n Ref. in Bankr. 55, 56 (April, 1959).)

The *Parchem* decision was based on a belief in the magic of the labels “perfected” or “specific” as applied to the federal tax lien, concepts which, as seen elsewhere in this brief, have no materiality for present purposes. See footnotes 2 and 6, *supra*. In failing to distinguish between statutory and consensual liens, moreover, *Parchem* not only overlooks the effect upon the former had by Section 67c(1) of the Bankruptcy Act, 11 U. S. C., Sec. 107c(1), but also does not recognize the fact that “The discretionary control of a court over interest not based on a contract is traditional.” (*Sword Line v. Industrial Commissioner of State of N. Y.*, 212 F. 2d 865, 870 (C. A. 2, 1954).)¹¹

¹¹Although the taxes in *Sword Line* were not supported by liens, the majority opinion apparently does not distinguish between liened and non-liened taxes insofar as the right to interest is concerned.

Thus, with the lone exception of *Parchem*, the lower courts have seen that the Supreme Court's opinion in *New York v. Saper*, 336 U. S. 328 (1949), is grounded on reasoning applicable to statutory lien claims. In this connection, the following language used in *Saper* is significant:

“Other decisions of this Court cited by petitioners [taxing agencies] on this point do not help their cause and require little discussion. *Dayton v. Stanard*, 241 U. S. 588, approved payment of interest to individuals who, during the course of a bankruptcy, paid off tax liens binding property of the bankrupt. The Court's decision was only that such parties, whose tax deeds were invalidated because at the time they were issued the property was *in custodia legis*, could be reimbursed out of the estate's general fund for both their advances and interest at the legal rate. This was simple equity since the claimants had paid taxes which the then §64(a) required the trustee to seek out and pay in full.” (336 U. S. at 336.)

The point is that the *Saper* Court distinguished the payment of post-bankruptcy interest on a tax lien in *Dayton v. Stanard*, not because statutory liens are entitled to such interest under an exception to the general rule, as the Government here contends, but for the sole reason that before the Chandler Act of 1938 all tax claims, liened or unliened, were payable by the trustee in full, including interest to the day of payment. Had the Court in *Saper* believed that the law contemplated post-

petition interest on tax liens whenever the assets were sufficient, it is reasonable to assume that this would have been set forth as a ground for distinguishing the *Dayton* case.¹²

Finally, the policy consideration advanced by Appellant, to the effect that allowance of post-bankruptcy interest is necessary in order to protect the public revenue (See, *e.g.*, Op. Br. p. 50), is without merit. In the first place, accepting it would mean the payment of similar interest to all non-governmental statutory lienors whose liens are not invalidated by Section 67c(2) of the Bank-

¹²In an attempted distinction of *Saper*, the Government seems to find some comfort in *Goggin v. California Labor Div.*, 336 U. S. 118 (1949), a case in which the question of allowability of interest accruing either before or after bankruptcy was not before the Court, nor was it discussed. Rather, the decision concerns whether the postponement provisions of former Section 67c applied where the Government seized the liened assets prior to bankruptcy, but thereafter voluntarily relinquished them to the trustee. Appellant's brief, however, contains an unfortunate typographical error when it quotes from *Goggin* for the proposition that the Supreme Court there interpreted the intent of Congress "to continue to safeguard interest [sic] under liens perfected before bankruptcy." (Op. Br. p. 43.) Actually, the Court in *Goggin*, in the quotation referred to, used the word "interests" rather than "interest," a difference of tremendous importance for present purposes. See 336 U. S. at 126-127.

That the right to "interest" was not considered in *Goggin* was expressly stated:

"There is no issue here as to the amount of penalties or interest included in the Collector's claim for taxes or as to the date to which interest on such claim shall be computed. There is no issue here as to any difference between statutory liens which were perfected more than four months before the filing of the petition in bankruptcy or those perfected within less than that time." 336 U. S. at 123, n. 3.

ruptcy Act, 11 U. S. C., Sec. 107c(2), including mechanics' liens, repairmen's liens, warehousemen's liens, and the myriad others.¹³ Except for cases where Section 67c(2) applies, their statutory liens are just as much secured indebtednesses as are the tax liens. If the so-called third exception to the general rule prohibiting interest after bankruptcy is extended to the present case, it would be impossible logically to refuse to apply it where a private statutory lienor is involved. This is the reason that Appellee believes the question in this case concerns post-bankruptcy interest on all statutory liens, rather than the more limited statement of the issue set forth by the Government.

Secondly, the public revenues are depleted to the same extent when interest is denied to ordinary taxes as when it is disallowed on those supported by liens. Yet, the Supreme Court in *Saper* found the present policy argument unconvincing.

In the third place, more forceful policy considerations can be urged in favor of the general unsecured creditor, whose dismal plight in bankruptcy is only too well known. The allowance of interest on claims, both secured and un-

¹³State-created statutory liens, as well as federal liens, on real estate are unaffected by Section 67c(2). State-created statutory liens (other than state tax liens) on personal property are subject to invalidation by that section only in cases where the lienor has not seized or levied on the personalty before bankruptcy. State tax liens apparently stand on the same footing as federal liens, being subject to postponement under Section 67c(1), but not to the voiding provisions of section 67c(2). *Rochelle v. City of Dallas*, 264 F. 2d 166 (C. A. 5, 1959).

secured, has long been recognized to involve “a balance of equities.” For example, in *Vanston Committee v. Green*, 329 U. S. 156, 165 (1946), a case where the Court disallowed interest which accrued after bankruptcy on unpaid secured bond interest, it was said:

“It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor . . . In this case, where by order of the court interest was left unpaid, we do not think that imposition of interest on that unpaid interest can be justified by ‘an application of equitable principles.’ ”¹⁴

Requiring trade creditors, who are already unfortunately treated by the Bankruptcy Act, to suffer further by the payment of post-bankruptcy interest on statutory liens out of the only source of their dividends, would hardly be the kind of “equity” referred to in the *Vanston* opinion. Especially is this so where, in most cases as seen above, a substantial delay in paying the lien claim is compelled by the law itself.

¹⁴The question of whether simple interest on the secured indebtedness accrued after bankruptcy was not before the Court in the *Vanston* case.

Conclusion.

For the foregoing reasons, the order of the District Court should be affirmed.

Respectfully submitted,

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